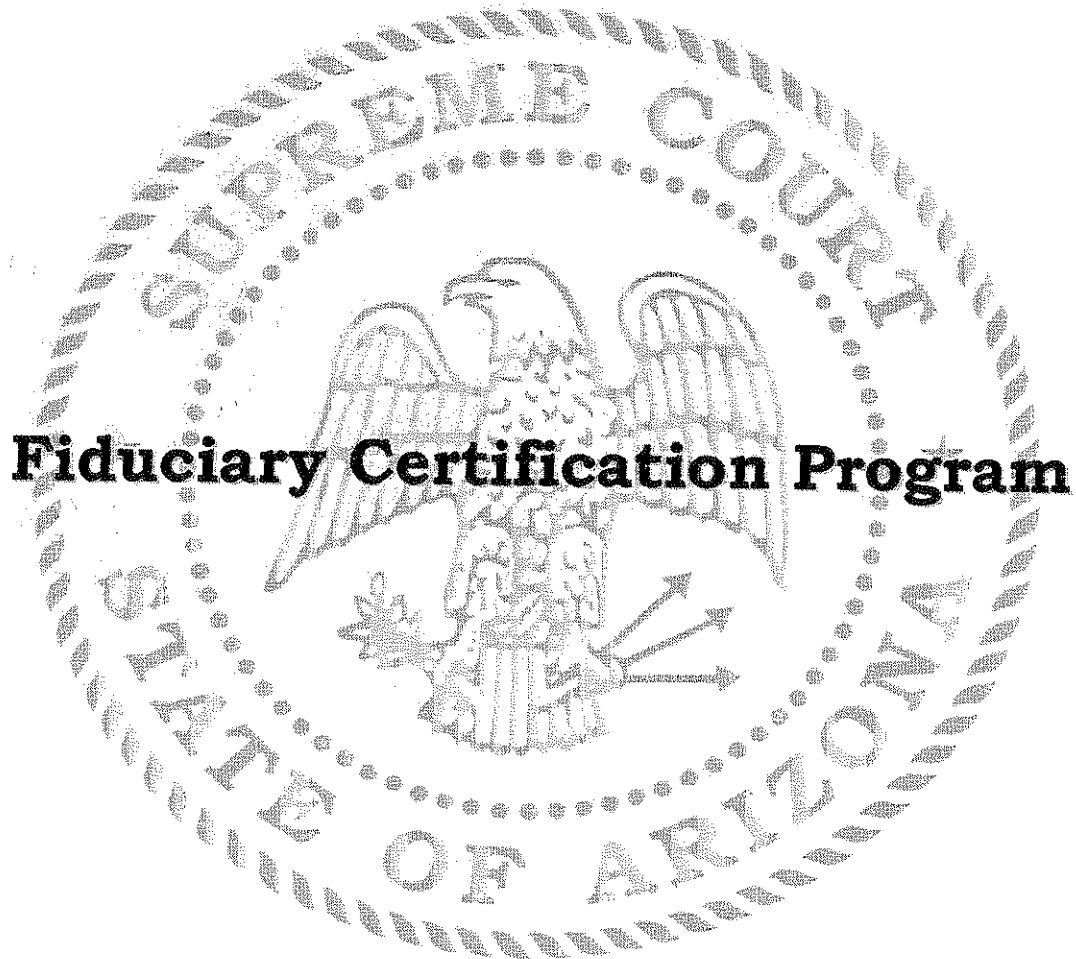


Arizona Supreme Court
Administrative Office of the Courts



Compliance Audit

Certified Fiduciary Services, Inc.

March 2003



Supreme Court

STATE OF ARIZONA

ADMINISTRATIVE OFFICE OF THE COURTS

Charles E. Jones
Chief Justice

David K. Byers
Administrative Director
of the Courts

May 15, 2003

Pamela Johnston
President/CEO
Certified Fiduciary Services, Inc.
10765 NW Grand Avenue
Sun City, AZ 85382

Re: Certified Fiduciary Services Compliance Audit Report

Dear Ms. Johnson:

Enclosed is the final compliance audit report for Certified Fiduciary Services (CFS). Thank-you for your written response to the draft you received. You will find a copy of your response and a letter of conclusion as appendices to this report.

Thank you for your cooperation and assistance during the pilot compliance audit process. To the extent the new fiduciary audit process will assist the court ensure the safety, health and welfare of individuals and estates entrusted by the court to your management, we have benefited from our audit of CFS. I hope CFS and its clients will equally benefit.

If you have any questions, please let me know at (602) 364-2378.

Sincerely,

Nancy Swetnam, Division Director
Certification and Licensing Division

Enclosures

c: Director, Administrative Office of the Courts, Dave Byers
Honorable Colin Campbell, Presiding Judge
Honorable Barbara Mundell, Presiding Probate Judge

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Disclaimer

This final report represents the information and conditions encountered at the point in time of the audit and does not purport to represent conditions prior to or subsequent to the performed audit. In addition, the information presented does not represent an endorsement or denunciation of the audited fiduciary or business.

After this report is distributed to the audited fiduciary, presiding judge of the county and, if a public fiduciary, the county supervisors, it becomes public record.

SECTION 1

Certified Fiduciary Services

Compliance Audit Report

Objective

The pilot compliance audit was conducted pursuant to the Fiduciary Program's responsibilities as set forth in A.R.S. §14-5651 and Arizona Supreme Court Administrative Order 2003-31.

The objective of the pilot compliance audit was to determine compliance with applicable statutes, Arizona Supreme Court orders and rules, local court rules and the Fiduciary Program rules and Code of Conduct.

Methodology

In preparation for the pilot compliance audit, preliminary survey questions were given and responded to by CFS. The responses were reviewed and compiled to assist in the development of case file samples. In addition, information was requested from the Superior Court in Maricopa County to verify court appointment information.

In preparation for testing for compliance, the program developed fiduciary compliance attributes from Arizona statutes, Arizona Supreme Court rules and Fiduciary Program Certification rules and local jurisdiction court rules. Compliance with these requirements was verified by staff interviews, observation and reviewing samples of client case files.

A random sampling approach was used. The selected samples of court appointed client case files were designed to provide conclusions about the validity and timeliness of transactions, internal controls and compliance with attributes. Client case files were selected for testing by type of appointment, length of appointment, amount and type of assets and initiation or termination of appointment during the review time frame.

Scope

During the period of March 3, 2003 to March 11, 2003, the Fiduciary Program of the Certification and Licensing Division of the Administrative Office of the Courts, Arizona Supreme Court, conducted a pilot compliance audit of Certified Fiduciary Services, a private fiduciary business. The audit included the fiduciary activities of the business principal, certified staff and support staff.

Certified Fiduciary Services (CFS) currently has four full time and three part time staff. Two of the full time staff are certified

Certified Fiduciary Services

Compliance Audit Report

fiduciaries. CFS is currently the court appointed fiduciary on twenty-five (25) conservator or personal representative cases. In addition, CFS represents other clients through private contracts for service.

The compliance audit team reviewed a sample of the 25 cases of court appointments and terminations during the period of January 1, 2001 through January 1, 2003.

Certified Fiduciary Services

Compliance Audit Report

Finding # 1

➤ Late filings

Related Attributes:

ARS 14§3505(B);

ARS 14§3706;

ARS 14§5419(A);

Arizona Code of Judicial

Administration §7-202,

Appendix A, Code of Conduct

Standard 2.e, 4.i, 5.h.;

Maricopa County Local

Rule 5.16

The compliance audit revealed late filings of court documents such as inventories, estate management plans and annual accountings. State statutes and local rules are very precise on the time lines for required court submissions. Of the six sampled client files, three client files had late court submissions. There was no evidence of documentation requesting or granting extensions for mandated deadlines for court submissions. The preliminary information provided by CFS on all of their active cases during the audit period showed additional late filings; however, those files were not sampled or reviewed for documentation granting extensions for required court submissions.

Requirements

CFS shall submit all required inventories, estate management plans and annual accountings by the statutory and/or local rule required timelines.

Auditee's Response

CFS will endeavor to submit all required inventories, estate management plans and annual accountings by the statutory and/or local rule required timelines. In addition, CFS will notify the court in writing whenever it appears that documents are not going to be filed in a timely manner and explain the reason.

Corrective Action

CFS has developed a court docket spreadsheet, designated a staff member to monitor the timely filing of court documents and instituted a computerized docket tickler system.

Subsequent to the audit CFS has developed a written Policy and Procedures document regarding the preparation and filing of the Inventory and Appraisement.

Certified Fiduciary Services

Compliance Audit Report

Finding # 2

➤ Personal Property Documentation

Maintenance of accurate and complete documentation is critical in managing the estate of a protected person or a decedent. Documentation related to the existence and management of personal property was not apparent in the case files. Upon discussion with CFS staff it was related the personal property records were kept separate from the estate files.

➤ Non-Cash Assets Documentation

Critical to understanding the assets and resources available to a client or to an estate is the knowledge of the existence of non-cash assets such as burial policies or pre-paid items and term life insurance. According to accepted accounting practices non-cash assets are assigned a nominal value for reporting purposes or listed elsewhere. The client case files reviewed did not list or document for the court these client specific assets.

➤ Waived requirements Documentation

In addition, for one estate, the court waived the statutorily mandated court submissions but there was no documentation in the file to that effect. Consequently, reconstructing the proceedings for this estate was not possible and fails the requirement for suitable records.

➤ Prudent Investor Documentation

One estate had four (4) different stocks which were placed with a brokerage. During the administration of the intestate estate the stocks declined significantly in value. The fiduciary actively communicated with the broker who advised against selling the stock during that period. There was no documentation detailing those communications with the broker. Therefore no documentation exists for the fiduciary to defend their decision making at that time.

Related Attributes:

ARS §14-5418(B)

ARS §14-7602(C)

ARS §14-7603

Requirements

The fiduciary will provide either a separate formal list of non-cash assets or include them on the inventory and/or accountings required by the court.

The fiduciary will routinely include court documentation granting waived requirements in the client case file.

The fiduciary will document professional recommendations regarding the management of estate financial assets.

Certified Fiduciary Services

Compliance Audit Report

Auditee's Response

CFS believes they maintain exceptional records and documentation regarding the personal property and assets owned by each protected person or decedent.

CFS stated it is understandable the court and other interested parties should be aware of the existence of non cash items. In the future CFS will list all known non cash assets on both the inventory and appraisal and the annual accountings.

Regarding court waived requirements documentation, CFS will request in the future all attorneys representing CFS send copies of minute entries they receive and those minute entries will become a part of the CFS file.

(Auditor Note) CFS disagreed with the original finding of a violation of the prudent investor rule. Based on the information presented in CFS's response, the finding was changed to a lack of documentation of decisions based on professional recommendations.

Corrective Action

CFS will either reference or include in the client case files evidence of the value and disposition of personal property and assets.

CFS will list all known non cash assets on both the inventory and appraisal and the annual accountings.

CFS will include conformed copies of court minute entries and court orders in client case files.

CFS will document professional recommendations utilized as a basis for management decisions on client investments.

SECTION 2



Supreme Court

Charles E. Jones
Chief Justice

STATE OF ARIZONA
ADMINISTRATIVE OFFICE OF THE COURTS

David K. Byers
Administrative Director
of the Courts

May 15, 2003

Pamela Johnston
President/CEO
Certified Fiduciary Services, Inc.
10765 NW Grand Avenue
Sun City, AZ 85382

Dear Ms. Johnson:

We have received your letter responding to our audit of Certified Financial Services (CFS) and want to thank-you for your suggestions on the audit process and the detail of your audit findings responses. The completeness of your response letter has been instrumental to understanding your processes and systems.

Your suggestion regarding specific case references will be implemented on future audits. The challenge will be to maintain client and proprietary confidentiality yet be specific enough for an auditee to identify the case file addressed in an audit finding. This will be accomplished by assigning each reviewed case file a discreet number known only to the auditee and auditor.

The Fiduciary Certification Program is currently working with the superior court to improve their probate information systems. Ongoing discussions with the Superior Court in Maricopa County administrators on their data systems are occurring. Currently the Superior Court in Maricopa County has CFS listed with twenty-five (25) open probate cases. The discrepancy between your caseload figure of eighteen (18) and the court's of twenty-five appears to be related to how cases are counted. Regardless, we will continue to work to resolve these differences. It should also be noted the audit results were not affected by the caseload discrepancies.

Finding # 1: Late Filings – *FINDING STANDS*

On case file # 04 (case file numbers and names are attached to this letter) CFS was late on the inventory violating the listed statutes and local rule. On case files # 01 and 02 CFS was late with the annual accounting violating court order, statute and local rule. Using CFS's own court docket spreadsheet reveals additional untimely court submissions.

A certified fiduciary is required to comply with statutes, rules and code to maintain their certification. Whether the court monitored or discovered and acted on the lack of timeliness of court submissions is not an issue of compliance on your part.

It is recognized the implementation of your court docket spreadsheet system and the designation of a staff member to monitor timelines will enhance your ability to meet required timelines in the future.

Finding # 2: Documentation – *FINDING STANDS*

The client personal property records maintained by CFS were not presented to the auditors nor referred to in the client files reviewed by the auditors. While CFS may maintain an exceptional records and documentation system for personal property, the auditors are required to verify its existence, adequacy and accuracy from information in the client files presented.

“Non-cash” is a term of art intended to refer to an asset with no cash value. Such assets would include burial policies, pre-purchased items such as head stones, term life insurance, pre paid funeral arrangements and life estate beneficial interest. All items which are a benefit and/or asset to the estate should be listed in order to provide the court a complete picture of the estate.

CFS client case file # 03 contained no proof of waiver of statutory requirements to provide an inventory. If a waiver was granted by minute entry, a conformed copy of the minute entry should be present in the client files.

Finding # 3: Prudent Man Rule – *FINDING CHANGED -- Documentation*

The report will be corrected to reflect the four securities as you have pointed out. The issue remains whether the client or estate was better served by leaving the stocks with the brokerage or liquidating the stocks. The fiduciary is required to invest and manage assets solely in the interest of the beneficiaries. While gains and losses may occur, it is not a requirement for a fiduciary to increase (or diminish) the value of an estate, only to act cautiously.

Your response states you were in frequent communication with the brokerage about the client's stock. However, no documentation existed in the client's case file detailing those recommendations from the broker. The only documentation in the client file was the client account brokerage statements.

Because you were acting based on professional recommendations at that time, this finding (Finding # 3) will be changed to reflect a lack of documentation regarding the broker's recommendations for the stocks. If questions are asked at a future date by the heirs or the court regarding the decisions by the fiduciary on the management of the client's stocks, documentation of the conversations with the broker would serve as a basis for your decisions at that time.

Conclusions from your response letter and this letter will be summarized and included in the final report.

Sincerely,

J. R. Rittenhouse
Fiduciary Program Manager
Certification and Licensing Division
Arizona Supreme Court

Kitty Boots
Fiduciary Program Review Specialist
Certification and Licensing Division
Arizona Supreme Court

Attachment

SECTION 3

Certified Fiduciary Services, Inc.

Post Office Box 1892 Sun City, Arizona 85372
(623) 977-6310, fax (623) 815-1141

April 24, 2003

Supreme Court
State of Arizona
Administrative Office of the Courts
Certification and Licensing Division
1501 West Washington Street
Phoenix, Arizona 85007-3231

Attention: J.R. Rittenhouse and Kitty Boots

Re: Fiduciary Certification Pilot Compliance Audit

Dear J.R. and Kitty:

First of all, I want to thank you for extending another week for me to respond to the Draft Compliance Audit Report. With tax season behind me it is much easier to focus.

I was pleased when we were selected to participate in the Pilot Compliance Audit and believe it has provided a valuable learning experience for my office as well as yours. I think we all agree that every audit will be somewhat different and will assist you in perfecting your audit tools and methodology. My staff and I sincerely appreciated your thoughtfulness and non-intrusive demeanor during the seven days you were here at our office.

At the time of the exit interview you requested that I be candid and open concerning my expectations and experience regarding the audit process. Following are some comments and observations that I hope will assist you in the future along with my response to your findings.

The letter that accompanied the report states "Every effort has been made to protect the privacy of your clients and the confidentiality of your proprietary business interests." While it is important to maintain client confidentiality it was difficult to provide specific responses to several non-specific case references in the report. As you know, each situation is different and circumstances frequently determine the decisions that are made and the method of performing the task at hand.

APR 28 2003



I also want to mention that I believe the audit findings should be limited to specific concerns or direct violations of statutory requirements, court rules or the Fiduciary Program rules and Code of Conduct. Personal opinions or preferences are not appropriate and should not be included in the report findings or require a written response.

As you know, we provided detailed information in response to the survey questions from your office. We included our case docket spreadsheets and information concerning every court appointed case we have managed. The report states that "CFS is currently the court appointed fiduciary on twenty-five (25) conservatorship or personal representative cases." Our records reflect that during the period covered by the audit (January 1, 2001 through January 1, 2003) we were court appointed on eighteen (18) conservatorship or personal representative cases. I realize there was some discrepancy between the information you received from the court and the CFS case docket. As we previously discussed, there were a number of duplications and errors contained in the court's information. Therefore, I believe 18 was the accurate number of cases being administered by our office during that period of time.

Response to Finding #1: Late Filings

The report states "Of the six sampled client files, three client files had late court submissions." Unfortunately, I do not know which three client files are referred to in the report. As stated previously, it is difficult to provide a specific response to a non-specific reference. I assume "late" means one day or more past the statutory deadline. As you are aware, CFS has never received a minute entry or citation from the court regarding late filings.

Without knowing which cases are referred to in the report, I can only say that there are several reasonable explanations why late submissions may have occurred.

- (1) CFS is frequently appointed as a successor conservator or personal representative in cases where a fiduciary has been removed or the interested parties can not reach a resolution without the assistance of an independent fiduciary. In some instances the prior fiduciary has already filed the required Inventory, Notice to Creditors, Annual Accounting, etc.
- (2) When a prior fiduciary has been removed or when there is infighting among the interested parties it is

often difficult to obtain the information necessary to prepare the Inventory and Appraisement within the statutory time frame.

- (3) A.R.S. Title 14, Sec. 14-3706 (B) also permits that in lieu of filing the Inventory and Appraisement with the court, a copy may be delivered or mailed to the heirs, devisees or other interested parties who request a copy. This has occurred on several occasions and therefore the court docket might not reflect the filing unless a Notice of Mailing was filed with the court.
- (4) On occasion there is a time delay between the date of appointment (date order signed) and the date letters are issued. Although the statutory deadlines begin counting from the date of appointment, the appointment order specifically states that it is not valid until letters are issued. In other words, we are unable to begin the process of gathering assets and information until our letters have been issued.

Our process for submitting timely documents to the court has improved over the past two years. Previously we relied on a manual docket system. CFS has implemented new procedures to facilitate the timely preparation of documents and tracking of court filings. As you know, CFS has developed a court docket spreadsheet. We have designated a staff member to monitor the timely filing of court documents via a computerized docket tickler system. Subsequent to the audit CFS has developed a written Policy and Procedures regarding the preparation and filing of the Inventory and Appraisement (see attached Exhibit A).

CFS will endeavor to submit all required inventories, estate management plans and annual accountings by the statutory and/or local rule required timelines. In addition, CFS will notify the court in writing whenever it appears that documents are not going to be filed in a timely manner and explain the reason.

Response to Finding #2: Personal Property - Documentation

CFS is acutely aware of the need for accurate and complete documentation. We have developed a comprehensive system for collecting and maintaining client records that facilitates the work flow of our office. Some of the personal property records, particularly, photo inventories, are maintained on a computer data base. There are no statutory requirements or court rules regarding the proper location or

maintenance of files, however, the report seems to imply that our system is inadequate. I strongly disagree. I believe CFS maintains exceptional records and documentation regarding the personal property and assets owned by each protected person or decedent.

Response to Finding #2: Non-Cash Assets – Documentation

I believe this finding centers on the fact that CFS does not customarily list “non-cash” assets such as burial policies and term life insurance on the Inventory or Annual Accountings. CFS does, however, maintain detailed files concerning every asset (cash and non-cash) for each estate it administers.

It would be helpful to clarify the report’s terminology “non-cash” asset. To my knowledge there is no such reference in the statutes or court rules. Should non-cash be construed to include not only burial policies and term life insurance, but other forms of future interests such as beneficiary designations or life estates?

A.R.S. Title 14, Sec. 14-3706 (A) and Sec. 14-5418 (A) reference only the listing of assets having “fair market value”. The current statutes and court rules do not provide specific guidelines concerning the content and format of the Inventory and Appraisal. To my knowledge there is no requirement that the Inventory or Annual Accounting comply with “accepted accounting practices”. If that were the case, much additional training and standardized formats would need to be implemented.

It is, however, understandable that the court and other interested parties should be aware of the existence of non-cash items. In the future CFS will list all known non-cash assets on both the Inventory and Appraisal and Annual Accountings.

Response to Finding #2 – Waived requirements – Documentation

Once again, I am unable to provide a specific response because I do not know which case is referred to in the report. I can only say that if the court waiver was done via court minute entry, it is possible that CFS did not receive a copy for the file. Customarily minute entries are sent to the attorney of record and not to CFS.

In the future CFS will request that all attorneys representing CFS send copies of minute entries they receive and those minute entries will become a part of the CFS file.

Response to Finding #3 – Prudent Man Rule

I am able to identify the case in question due to the detail provided in the report. I respectfully object to the analysis and conclusions drawn in the report. The finding is based upon a limited knowledge of the facts which I will now endeavor to supply.

The decedent's total estate was valued at less than \$150,000. The estate owned four equities having a combined value of less than \$50,000. On the date of decedent's death the equity in question was valued at less than \$15,000.

Prior to appointment as Personal Representative CFS served as Conservator and had deposited the physical stock certificates into a brokerage account. The equities had been owned by the protected person for many years; however, no records were available to establish the cost basis. A decision was made not to sell the equities during the protected person's lifetime because a large capital gain would have been incurred. The equities were in the process of being reregistered in the name of the conservatorship estate when the protected person passed away on 5/10/01 (less than 60 days after the appointment of CFS as Conservator). The decedent did not leave a will and there was very little information concerning the heirs. There was some delay in the appointment of CFS as Personal Representative because it was necessary to contact the 5 known heirs to obtain waivers of appointment. CFS was appointed as Personal Representative on 8/9/01. Thereafter CFS was told by the broker that it would be necessary to open a new account and reregister the equities in the name of the decedent's estate. The equities were transferred to the new account on 10/5/01. Unfortunately, on 9/11/01 a national disaster occurred which resulted in the immediate decline in value of most stocks listed on the New York Stock Exchange.

The report seems to place a great deal of significance on the "lengthy heir search" (47 heirs were eventually located). However, this was only a small part of the complications that ensued concerning the estate administration. Initially, some consideration was given to an in-kind distribution of the equities pursuant to A.R.S. Title 14, Sec. 14-3906(A). Of course, when it was determined that there were in excess of 40 heirs this was not a viable option.

The report states "No documentation was present to indicate active management of these assets." I strongly disagree. A detailed file was maintained for the brokerage account as well as each individual equity. During the course of the conservatorship and probate administration CFS

communicated regularly with the broker and received recommendations concerning the four equities in the account. Subsequent to the 9/11/01 disaster the broker advised CFS that all four of the equities were good quality investments and that it would not be advisable to "panic sell". It was believed that the equities would regain their prior value within a short period of time. In fact, three of the equities did exactly that. Only one of the equities continued to lose value prior to liquidation.

The report provides the opinion that "Since the stock would have to be liquidated to settle the estate, the liquidation should have occurred earlier in the administration of the estate ... ". In reality, the equity in question increased in value during the time CFS was serving as Conservator and did not begin to decline until after the protected person's death. The value of the equity as of the date of death (5/10/01) was 45.275 per share. As of the date of CFS's appointment as PR (8/9/01) the value was 30.91 per share, a decline of approximately 35%. Of course, CFS was not able to sell the equities until appointment as PR. From the date of appointment as PR until the equities were liquidated the equity in question declined in value by approximately 40%, not 65% as stated in the report. As we are all aware, many investment "gurus" and seasoned portfolio managers experienced similar losses during this same period of time.

If the asset in question had been sold on the day CFS was appointed as Conservator we might have been criticized for not holding the equity long enough. During the time period between CFS's appointment as Conservator and the protected person's date of death the equity increased in value by approximately 15%.

CFS has always taken a proactive role in the management of client assets. We are aware of the investment techniques mentioned in the report and have utilized a number of those techniques when appropriate. CFS makes every effort to select knowledgeable investment advisors. We monitor investment statements and communicate with brokers and investment advisors regarding their recommendations.

Based on the case specific circumstances and information available to us at the time, I believe CFS appropriately managed the equity in question and did not violate the Prudent Investor Rule.

Once again, I am pleased to participate in the Pilot Compliance Audit. Should any of the matters discussed above require further clarification please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script, reading "Pamela Johnston". The signature is written in dark ink and is positioned above the printed name.

Pamela Johnston

Enclosures

INVENTORY AND APPRAISEMENT

POLICY:

Certified Fiduciary Services, Inc. will make every effort to comply with the timely filing of an Inventory and Appraisement as required by Arizona Revised Statutes, Title 14, Sec. 14-3706 and Sec. 14-5418.

Within 90 days from the date of appointment as Personal Representative or Conservator, CFS will prepare and file with the Court an inventory of the estate owned by the decedent/protected person as of the decedent's date of death or the date of appointment as Conservator. The inventory will be prepared using a format acceptable to the Court.

PROCEDURES:

CFS will locate and secure all assets owned by the decedent/protected person and any asset(s) which are known to be in the possession of others.

CFS will locate and secure all records pertaining to assets owned by the decedent/protected person as follows:

- Search the residence last occupied by the decedent/protected person
- Contact family members, friends and professional advisors of the decedent/protected person
- Change the mailing address of the decedent/protected person to the address of CFS
- Conduct an internet search regarding real property titled in the name of the decedent/protected person

CFS will immediately perform a photo inventory of the household furniture, furnishings, miscellaneous personal property, automobiles and real property owned by the decedent/protected person.

CFS will immediately prepare an inventory of the contents of any safe deposit box owned by the decedent/protected person.

CFS will determine the fair market value of all assets owned by the decedent/protected person; the nature of the asset(s) (separate or community); and the type and amount of any liens or encumbrances.

CFS will obtain appraisals when there is a reasonable doubt concerning the fair market value of any asset(s) owned by the decedent/protected person.

CFS will set up individual files for each asset owned by the decedent/protected person. Each file will contain a Property Management Information Form (PM 101, 102 & 103) describing the asset, the location, the estimated or appraised value and a copy of the photo inventory of the asset.